The CIBUK Clear Water Partnership

News Bulletin

Welcome!

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'Who's Laffing now?'

The Case for a Low Tax Economy

INTRODUCTION

With western economies engulfed in a perfect storm of escalating debt, rising inflation and sluggish growth, we turn our attention this week to GROWTH with a particular focus on how the UK can escape its current economic straitjacket.

In doing so it's worth recalling the now famous dinner which took place at the *Two Continents Restaurant* in Washington in December 1974 at which the US economist Arthur Laffer drew his famous curve on a napkin to illustrate the economic phenomenon which now bears his name:

His thesis was the trade-off between tax rates and tax revenues / something of major importance in the UK right now.

Put simply, it challenges the assumption that if tax rates are lowered, revenues will be lowered by the amount of the decrease in the rate.

According to Laffer, the reverse is true:

"The economic effect recognizes the positive impact that lower tax rates have on work, output, and employment - and thereby the tax base - by providing incentives to increase these activities.

Raising tax rates has the opposite and negative economic effect by penalizing participation in the taxed activities. The arithmetic effect always works in the opposite direction from the economic effect."

The evidence, current and historic is so overwhelming that we feel compelled to devote this week's Bulletin to the cause in the hope that theUK Government will not be deflected by siren voices but stick to its guns and act accordingly.

SUMMARY OBSERVATIONS

- **The Laffer curve is not new:** examples abound of its successful implementation years before it acquired a name.
- **Neither is it a relic:** recent examples suggest it remains as relevant today as it was when it was first tried.
- **Nor is it exclusive to a political tradition:** President John F Kennedy (Democrat) and John Maynard Keynes (Liberal) were as enthusiastic as any conservative.
- **It has global reach and relevance:** the information below contains data from the UK and from a range of developed economies around the world to illustrate the point.
- **Wider policy rationale:** because tax cuts create an incentive to increase output, employment, and production, they also help balance the budget by reducing means-tested government expenditures.
- **A faster-growing economy** means lower unemployment and higher incomes, resulting in reduced unemployment benefits and other social welfare programs.
- **Equity:** when top-rate taxes are reduced, the top earners end up paying a higher proportion of the total tax take.

ILLUSTRATING THE LAFFER CURVE

International evidence shows clearly that cutting top marginal tax rates invariably increases revenue. Just as importantly <u>it demonstrates</u> that raising them <u>reduces</u> revenues. Here are some international examples including the UK:

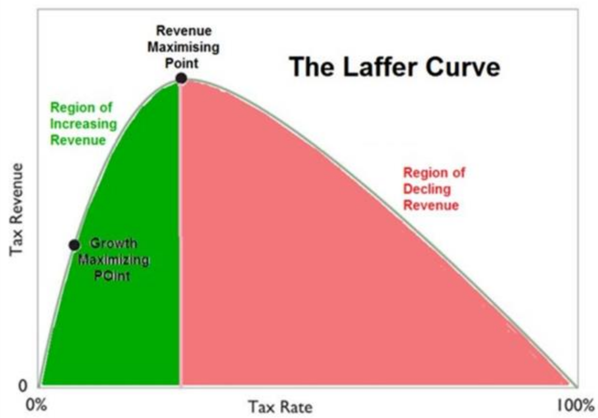
UNITED KINGDOM

For policy makers in the UK the evidence is equally compelling: tax cuts increase revenue and highest payers pay a higher % of the total take

- In 1979 Chancellor Geoffrey Howe cut the top rate from 83% to 60%. Before the cut, the top 1 percent of UK taxpayers paid only 11% of the total income tax take. By 1988 they were paying 14% of income tax revenue.

- In 1988 Nigel Lawson cut top rates from 60% to 40% and receipts rose further. **By 1997 the top 1% of earners paid a huge 21% of the total tax bill.**

- In April 2013 Chancellor Osbourne cut the additional rate of income from 50% to 45%. In the subsequent year **£8bn more revenue was raised**. The top 1% of taxpayers now pay **30% of income tax**.



INTERNATIONAL EXAMPLES

The United States

- The top rate of US income tax was raised to 71% during WWI with dire economic results and was later cut to 25% by Presidents Coolidge & Harding. As a result, revenues nearly doubled. The share of tax paid by those earning over $100k rose from 28% in 1921 to 51% in 1925.

- President Kennedy's 1963 tax cuts reduced taxes at all levels, cutting the top rate from 91% to 70%. Total income tax revenue increased from $68.8 bn in 1964 to $95.7 bn in 1968. The share of tax paid by those earning over $50k went up from 12% in 1963 to 15% in 1966.

- President Reagan cut the top rate of US income tax from 70% to 50% in 1981 and cut the top rate again to 28% in 1986. The share paid by the top 10% of taxpayers increased from 48.0% in 1981 to 57.2% in 1988.

The opposite is also true

- President George HW Bush raised the top marginal income tax rate to 31% in 1990. Tax receipts fell as a % of GDP and in 1991 after the tax increase richer taxpayers paid $6.5 billion LESS than they had in 1990.

- **These were later reversed by his son George W. Bush.In 2003 reduced the highest rate of income tax from 39.6% to 35% and the dividend tax from 39.6% to 15%. From 2004 to 2007 federal tax receipts increased by $785 billion with the bulk of that coming from the better off**

GLOBAL PHENOMENON

It may have been named after a US economist, but the observations from the Laffer Curve hold true across the globe :

CANADA

When the top federal tax rate in Canada was cut from 45% in 1981 to 29% in 1990, the share of tax receipts paid by the top 10% of taxpayers grew from 29% in 1981 to 45% in 1992

INDIA

India in 1984 reduced its top income rate from 65% to 50%. As a result, tax revenue in the 1985 fiscal year rose by 20% over 1984

SWEDEN

Sweden increased income tax for high-earners by 3% to 60% in 2016. The affected group reduced their earnings and less revenue was raised.

WIDER POLICY IMPLICATIONS FOR THE UK

Whether we like it or not, the UK relies very heavily on the taxes paid by the top 1.7% of earners. If we want to keep providing the current level of health, education and welfare services to the rest of the population we have to ensure we have enough wealthy taxpayers.

- There are surprisingly few higher rate taxpayers in the UK. In 2021/22 a mere 563,000 people paid the additional 45% rate, that is only 1.7% of all UK taxpayers and about 0.8% of the UK population.

- Despite making up such a small part of the population the additional rate taxpayers are expected to pay 36% of all income tax in 2022/23, (£89.2bn out of £251 billion). The economy relies on the tax contribution of this tiny proportion of the population

- If they left the country, we would all have to pay a lot more tax or get used to much lower levels of public services. There is a lot of competition for high earning individuals.

CITY OF LONDON

The importance of the UK's financial services industry to the debate cannot be overstated:

- According to the latest House of Commons figures, 1.08 million jobs in the UK are in financial services: 3.0% of all jobs.
- Exports of UK financial services were worth £61.3 billion in 2021 and imports were worth £16.6 billion, so there was a surplus in financial services trade of £44.7 billion.
- Taxes raised on the financial services industry raised £28.8bn in 20/21, or over 4% of all taxes collected that year according to HMRC.

REMAINING COMPETITIVE

- Other financial centres have much lower taxes. In the US someone earning $170,000 (£153,000) has a federal income tax rate of 32% while the top US rate of federal income tax is only 37% and only on income over $539,900 (£486,000).
- In Singapore income taxes are even lower. Someone earning over S$240,000 (£150,000) pays 19.5% income tax while in 2024 Singapore's top tax rate will be 24% on earnings over S$1 million (£624,000), with 19.9% paid on earnings below this level.
- Attracting more high-earning bankers away from New York and Singapore and back to London is important, not only do the top 1.7% of earners in the UK pay 36% of our income taxes they cost the government very little.
- So, it is helpful that the government has also removed the cap on bankers' bonuses. Bankers are not employed by the government so why would the government want to limit their earnings? The Government is already charging banks an 8% tax surcharge above the normal corporate tax.
- Lowering taxes and attracting more high earners to Britain might help balance the books and would send a powerful signal that Britain is once again fully open for business.

Conclusion

The data we have assembled is not anecdotal but overwhelming and almost universal. If Britain is to apply the economic lessons of the past AND take advantage of its new-found fiscal freedoms outside the EU, that time is surely now.

We have repeatedly invoked arguments for lowering tariffs and will continue to do so. But it must be placed within the context of an overall drive to lower taxes across the board (including the top rate) and to take on those who argue the contrary case.

It is not too much of an exaggeration to say the fortunes of this generation depend on the success of winning that argument over the next two years.

For a full account of the history of the Laffer Curve and the data behind the bulletin above, we enclose the following two links:

The Laffer Curve: Past, Present, and Future | The Heritage Foundation

https://twitter.com/CutMyTaxUK/status/1575525455733542913?s=20&t=kxglmvFDXykIG42ylGvo5g

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About CIBUK: The Campaign for an Independent Britain (**CIBUK**) is a non-party political campaigning organisation of people from all walks of life. It is the UK's longest-running membership organisation for freedom, democracy and independence.

Founded in 1969, for over 50 years the CIBUK has made a significant contribution in campaigning on issues important to the majority of our population and in securing our exit from the European Union. Now it's time for the next chapter.